

Honorable Mayor and City Council of the City of San Diego, California

The purpose of this report is to provide the Mayor and City Council with the issues that are being addressed in development of the Fiscal Year 2004 Proposed Budget. A summary of the points that are highlighted in this report include:

1. **Fiscal Year 2004 Economic Environment**

This section identifies economic conditions that are impacting the preparation of the Proposed Budget. In Fiscal Year 2004, growth of major revenues are expected to be lower than historical trends.

2. **General Fund Budget Strategy**

This section identifies expenditure requirements, General Fund Budget balancing strategies, and proposed revenue enhancements. The Fiscal Year 2004 Proposed Budget will be primarily balanced using expenditure reductions, which is in addition to expenditure reductions made in Fiscal Years 2002 and 2003.

3. **General Fund Revenue Options**

This section summarizes potential revenue ideas which have been identified as a result of City Council discussion on February 24. Revenue enhancements are an alternative to further reductions given that expenditures are increasing at a faster rate than existing revenues. These revenue options are scheduled for discussion at the Committee on Rules, Finance and Intergovernmental Relations on April 2, 2003.

4. **State Impact**

This section includes a summary of the potential impacts of the State of California's deficit on the City's Fiscal Year 2004 Proposed Budget. The Fiscal Year 2004 Proposed Budget submitted to the Mayor and Council in May will exclude potential State actions.

FISCAL YEAR 2004 ECONOMIC ENVIRONMENT

As indicated in the Fiscal Year 2003 Financial Review and Status report presented to the City Council in February, San Diego's economy continues to outperform the State and national economies. However, recovery remains slower than anticipated, particularly in Sales Tax, and recent developments have made the outlook for Fiscal Year 2004 even less optimistic. The University of San Diego's Real Estate Institute reports that the manufacturing base continues to decline due to high labor costs. Increased military deployment, rising gas prices, and the possibility of war threaten to erode local consumer spending. The California Employment Development Department recently reported that the unemployment rate in San Diego County increased to 4.4 percent in January, matching the highest rate in five years, although still well below State and national figures. Consumer confidence has fallen rapidly according to a recent Union Tribune poll, declining 20 percent since January 2001 to one of the lowest points in history.

Fiscal Year 2004 Financial Forecast

San Diego's lodging industry, while one of the strongest in the nation, is still recovering from the September 11 terrorist attacks. Although the City's hotel occupancy rate was ranked third in the nation in 2002 by Smith Travel Research, behind only New York City and the island of Oahu, tourism remained relatively flat. The San Diego Convention and Visitors Bureau reported that the City's hotel occupancy rate for 2002 was down two percent from 2001, and the average daily room rate held steady. The total number of overnight visitors increased 1.6 percent from 2001, but visitor spending declined by 1.6 percent. For Fiscal Year 2003, Transient Occupancy Tax revenues are expected to come in at budgeted levels.

Consumer spending is likewise poised for slow growth due to declining consumer confidence, weak job growth, and spiraling fuel costs. As gas prices rise, consumers are forced to spend more of their discretionary income on fuel. Alan Gin, an economist with the University of San Diego, estimated that the regional economy loses \$5 million for each 10-cent per gallon increase in the price of gasoline. According to *Economy.com*, a leading provider of economic data, national retail sales fell 1.6 percent in February, with weak sales across most store groups. Non-auto sales fell 1.0 percent, the biggest decline since September 2001. In addition, the recent increase in military deployments has weakened the local consumer base.

Although San Diego's real estate market has been a pillar of strength for the local economy, signs indicate the market will have slower growth. The California Association of Realtors reported that the fourth quarter of calendar year 2002 sales activity was down eight percent from the third quarter. Furthermore, January sales of existing single family homes were down 8.59 percent from January 2001, according to the San Diego Association of Realtors. The recent boom in the housing market has largely been due to record-low mortgage rates. If mortgage rates increase, further declines in the housing market can be expected.

Auto sales have been at record levels due to low financing costs. But like home sales, auto sales are beginning to show signs of cooling off. According to *Economy.com*, national auto sales were down in both January and February. Sales in February totaled 15.4 million units, compared to a monthly average of 16.7 million units over the previous six months. The declines are likely due to zero-percent financing and other incentives in 2002, which have "stolen" auto sales from 2003 and 2004.

GENERAL FUND BUDGET STRATEGY

The primary focus of the budget development process is to forecast revenues and account for expenditure requirements to meet the priorities of the Mayor, City Council and the citizens. Budgeting is a revenue-driven process. As the Blue Ribbon Committee report on City Finances acknowledged, San Diego begins the budget process from one of the lowest per capita revenue bases. In developing a fiscal plan within this economic environment, the proposed budget strategy has included using the revised Principles of Budgeting and Finance, in which a primary principle is to use ongoing revenue to support ongoing expenditures. Because General Fund revenues are not growing at the same pace as expenditure requirements, corresponding reductions to City operations are required.

An additional aspect of the Proposed Budget strategy has been to exclude adjustments due to the State of California budget deficit. The situation at the State level continues to be debated; therefore it is premature to build a proposed budget that reduces services without full knowledge of the State budgetary actions. The State budget situation is discussed further in this report. An overview of the City's current budget situation and proposed solutions is presented in the following section.

Fiscal Year 2004 General Fund Revenue Projections

The growth in the major General Fund revenues, which comprise 68 percent of all General Fund revenue, is primarily driven by the economy. The major General Fund revenues include Property Tax, Sales Tax, Transient Occupancy Tax, Motor Vehicle License Fees and Franchise Fees. Fiscal Year 2004 revenue estimates reflect an uncertain economy as previously discussed in this report. The net growth in the major revenues for Fiscal Year 2004 is currently estimated at approximately \$8-10 million.

This projection reflects a substantial reduction in Franchise Fee revenue. The price of natural gas has normalized since its peak in Fiscal Year 2002. As a result of this unexpected reduction in price, franchise fees in Fiscal Year 2003 are lower than budgeted and are expected to be reduced further in Fiscal Year 2004. Motor Vehicle License Fees (MVLF) are expected to experience some growth; however, there is a concern that the financing incentives of the past year have boosted vehicle sales to abnormally high levels, which could result in reduced revenues in the future. The Fiscal Year 2004 MVLF projection is conservative reflecting this potential change in sales. Property Tax is expected to continue to experience growth as evidenced by the real estate market in San Diego. Transient Occupancy Tax is projected to continue to grow, due to our solid lodging market. Sales Tax has been experiencing slow growth in Fiscal Year 2003, but is expected to improve in Fiscal Year 2004. Concerns still exist, however, on the effect that military deployment and war fears will have on consumer spending. Development of revenue estimates for Fiscal Year 2004 will continue to be refined as the Proposed Budget is developed.

Fiscal Year 2004 General Fund Expenditure Projections

Reliance on the annual growth of existing revenues, absent the provision of new revenue sources, greatly limits the City's ability to meet budgetary priorities and contractually obligated expenditures. Examples of the City's expenditure obligations follow.

Fiscal Year 2004 Financial Forecast

Personnel-Related Obligations

With personnel expenses accounting for 75.6 percent of the General Fund budget, salary and retirement rate increases will have a significant impact on Fiscal Year 2004 expenditure levels.

The City's projected increase in retirement contributions in the upcoming fiscal year can be attributed in part to plan improvements negotiated with the employee bargaining units, and the commitment to maintain the funding levels in the retirement system that were agreed to by the City and the San Diego City Employee's Retirement System Board. The primary reason for increases in contributions, however, is the significant market losses the Retirement System has suffered due to the decline of the stock market. A separate report on retirement contributions has been presented to the Rules Committee, and a follow-up report is scheduled to be presented on April 23, 2003.

Workers' Compensation costs have also risen sharply in recent years, due to rising medical costs, a marked increase in litigation, and extended claim duration periods.

New Facility Obligations

Operating expenses of new facilities previously approved by the Mayor and City Council must also be provided. Facilities scheduled to open in Fiscal Year 2004 include the Point Loma and La Jolla Libraries, Fire Station #46 in the Black Mountain Ranch area, and facilities at Balboa Park. Operating expenses must also be added to address Americans with Disabilities Act facility upgrades, and to maintain recently added open space acreage, joint-use areas and community parks.

Non-Discretionary Expenses

Annual increases in costs for such items as insurance, energy, and vehicle usage must also be accommodated in the upcoming budget year.

The following list of Fiscal Year 2004 General Fund changes in funding requirements is not intended to be complete, but identifies the approximate change in cost or major revenue receipts currently projected in these categories for Fiscal Year 2004.

Fiscal Year 2004 Financial Forecast

MAJOR REVENUE GROWTH OVER FISCAL YEAR 2003 BUDGET

Net Estimated Major Revenue Growth	\$ 8-10 million
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MAJOR EXPENDITURE GROWTH OVER FISCAL YEAR 2003 BUDGET

Previously agreed to costs including annualizations of salaries and benefits from FY 2003	\$ 18.0 million
Retirement contributions	\$ 12.8 million
Worker's Compensation costs	\$ 6.0 million
New facility and annualization operating costs (Park and Recreation, Library and Fire-Rescue Facilities)	\$ 3.7 million
Non Discretionary Accounts (Insurance, Energy, Vehicle Usage, etc.)	\$ 1.8 million
Estimated Department Reductions	(\$30.0) million

Net Expenditure Growth	\$ 12.3 million
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As this partial list reflects, the City's expenditure needs are outpacing the anticipated revenue growth, creating the need to make expenditure reductions. As a result, the development of the Proposed Budget will include reductions in City operations of approximately \$30 million, revenue enhancements and reallocation of resources between programs.

Fiscal Year 2004 General Fund Solutions

Some opportunities to help achieve a balanced Fiscal Year 2004 budget will include the following:

1. Reductions in City operations:

As the economy slowed and after the events of September 11, 2001, the City began taking actions to ensure the fiscal health of the General Fund:

- a. In Fiscal Year 2002, most General Fund departments reduced their spending by two percent of their budgets to accommodate shortfalls in revenue.
- b. In preparing the Fiscal Year 2003 Proposed Budget, most General Fund departments, including Police and Fire-Rescue, reduced their appropriations further by two percent to accommodate projected growth in revenues.

Fiscal Year 2004 Financial Forecast

- c. In the current year, most General Fund departments are reducing expenditures by three percent due to the persistent economic downturn, which caused further shortfalls in revenues. Public Safety departments are also implementing savings plans to reduce their expenditure projections. As mentioned in the Fiscal Year 2003 Financial Review and Status Report in February, all departments are adhering to savings plans including a hiring freeze and reducing non-discretionary spending.
- d. In the Fiscal Year 2004 Proposed Budget, most General Fund departments will reduce their appropriations further and there will be a Citywide reduction in operations.

The total reductions are currently estimated to be \$30 million, or the equivalent of 4.1 percent of the Fiscal Year 2003 General Fund. These reductions include decreases in park maintenance services, hours of recreation operations, facilities maintenance, library hours and community service centers. Public Safety departments will make reductions primarily comprised of decreases in non-sworn positions and operations. Every effort will be made to minimize Public Safety service level impacts.

2. Revenue Enhancements:

The Fiscal Year 2004 Proposed Budget is being developed with the following revenue enhancements, which require City Council approval.

- a. Refuse Hauler Franchise Fee Increase:
The Environmental Services Department will bring forward a proposal which includes an increase in the Refuse Hauler Franchise Fee. This report will be presented to the City Council prior to the adoption of the budget.
- b. Existing Parking Meter Fee Increase:
A fee increase on existing parking meters in the City will require an amendment to the Municipal Code. Staff will be evaluating the impact and will bring a report forward to the City Council prior to the adoption of the budget.

3. Other:

- a. The Proposed Budget assumes the utilization of Community Development Block Grant (CDBG) funds to support projects such as purchasing fire equipment, mandated Americans with Disabilities Act facility improvements and Neighborhood Code Compliance Services, which are eligible for the use of CDBG funds. If these monies are not utilized, further reductions would be necessary.

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- b. According to the Library Ordinance, the City Manager shall present a Fiscal Year 2004 Proposed Budget which appropriates an amount equal to at least 5.5% of the Proposed General Fund budget for Fiscal Year 2004. However, I propose to temporarily suspend this requirement for Fiscal Year 2004 in order to direct funds to priorities such as Public Safety. If approved, the Proposed Budget will maintain the Library Department Budget at approximately five percent of the General Fund in the Fiscal Year 2004 Proposed Budget, the same allocation that was in the Fiscal Year 2003 Annual Budget. This five percent will include anticipated grants.

If implemented, these actions will contribute to a balanced Fiscal Year 2004 Proposed Budget. However, State actions, as detailed later in this report, could create a further funding shortfall of approximately \$62 million, which is not accommodated in the Proposed Budget.

Community Input Process

To be responsive to the needs of the City Council and the residents of the City of San Diego, several mechanisms are in place to solicit public participation in the budget development process and to request citizen input in setting and revising the City's budget priorities. The collection of this information is an important component of the City's efforts to continually improve the total quality of service delivery and to be responsive to the City's customers. Citizen participation is facilitated through Community Budget Forums and Citywide resident and customer surveys. Community Budget Forums have been held in San Diego communities during February and will continue in March, through coordination by each Council Office. The schedule of Community Budget Forums is as follows:

February 20	7:00 p.m.	District 6	Linda Vista Recreation Center
February 26	6:00 p.m.	District 7	Mission Trails Regional Park Visitor Center
March 5	6:00 p.m.	District 8	Finney Elementary School
March 12	8:15 p.m.	District 2	Belmont Park Community Room
March 13	6:00 p.m.	District 1	La Jolla Recreation Center
March 19	6:30 p.m.	District 3	Balboa Park Club
March 20	6:00 p.m.	District 4	Tubman-Chavez Center
March 27	7:00 p.m.	District 5	Rancho Bernardo Library

GENERAL FUND REVENUE OPTIONS

At the City Council meeting of February 24, a request was made to bring forward options to enhance revenue in the General Fund. The following summaries introduce several potential enhancements. A report is scheduled to be given to the Rules Committee in April to discuss many of these revenue ideas in more detail. Although some of these options may be viable, some will require significant time for legal review, analysis and preparation prior to potential implementation. Additionally, most of these options require voter approval, which further extends the timeframe for implementation.

Admission Tax

An Admission Tax is levied on admission fees charged for attending a variety of events, shows or conventions, including concerts, movies, athletic contests, bowling, night clubs, or displays of live animals and/or plants. The City of Philadelphia and the City of Santa Cruz both employ a five percent tax rate. A five percent Admission Tax in San Diego would generate approximately \$4.9 million for the City's General Fund.

Business License Tax

Business License Taxes are charged to businesses for the privilege of conducting operations within a city's boundaries. These taxes are levied in many different ways, most commonly as a percentage of gross receipts or a fixed charge per employee. Often, rates are tiered depending on the size of the business or number of employees. Different rates are often charged to different types of businesses. Currently the City of San Diego levies a Business License Tax that is based on the number of employees. For businesses with less than 12 employees, the City charges a flat rate of \$34. For businesses with 13 or more employees, the City charges a flat rate of \$125 plus \$5 per employee. Based on Fiscal Year 2002 actual figures, doubling the Business License Tax would generate approximately \$5.3 million per year in additional General Fund revenue.

Paramedic Subscription Program

In an effort to enhance the City of San Diego's first-response capabilities to medical emergencies, the San Diego Fire-Rescue Department is developing a proposal to institute a voluntary first-response Paramedic Subscription Program. Under this program, households and businesses would have the option of paying an annual subscription fee. Those who elect to pay the fee would not be charged if first-response medical service is required. Those who choose not to pay the voluntary subscription fee would be billed for emergency medical first-response. Transport fees would still be charged to all users when applicable.

Parking Lot Tax

The Parking Lot Tax is levied on the gross receipts from all financial transactions involving the parking or storing of automobiles or other motor vehicles in outdoor or indoor parking lots and garages. The person operating or conducting the parking facility is responsible for issuing the claim check, collecting the tax and paying it to the city. Cities such as Los Angeles and Santa Monica charge a tax of 10 percent on each parking transaction. Other cities charge 15 to 25 percent, as found in Philadelphia and San Francisco, respectively. A tax rate of 10 percent could generate approximately \$19.6 million in additional revenues for the General Fund.

Property Transfer Tax

The Property Transfer Tax, sometimes referred to as a documentary transfer tax, is paid on the sale of any real property. The tax is based on the purchase price of the property at the time of sale. Most cities levy a so-called “conforming” tax, whereby the county charges \$1.10 per \$1,000 and the city charges \$0.55 per \$1,000. The city tax is then credited against the county tax, such that both the city and the county receive \$0.55 per \$1,000 of the sale price. Some cities levy a “non-conforming” property transfer tax at a rate above \$0.55 per \$1,000. In these cases, the city tax is not credited against the county tax. The county receives the full share of the \$1.10 per \$1,000, and the city receives the amount generated from its own tax rate. Currently, San Diego levies a “conforming” tax rate of \$0.55 per \$1,000. Based on Fiscal Year 2002 actual receipts, an increase in the property transfer tax to \$2.75 per \$1,000, a rate equivalent to that in Sacramento, would generate over \$28.1 million a year in additional General Fund revenue.

Public Safety Property Tax Assessment

An additional Property Tax Assessment for public safety services could be levied on new development in the City. As proposed in the City of Elk Grove, California, for example, this tax would not be levied on current homes, only future development, and would be designed to increase with inflation. Service levels to the new developments would not differ from services to established communities. Because in most cases each new household costs a city more in services than it contributes in taxes, the City has been falling behind in its ability to recover the costs of basic services such as public safety. Based on new residential construction in 2001, a Public Safety Property Tax Assessment of \$275 on each new dwelling unit would generate approximately \$1.8 million in General Fund revenue.

Refuse Collection Fee

The Refuse Collection Fee is a charge for the service of residential refuse collection and disposal. It is levied as a monthly charge per refuse container to each household that receives municipal refuse collection service. San Diego is the only major California city that does not attempt to recoup at least a portion of the cost of providing refuse collection service. A flat monthly rate of \$10-13 per household would fully recover the cost of residential refuse collection. While instituting a refuse collection fee would not require a vote under Proposition 218, majority approval would be required to amend Municipal Code Section 66.0127, enacted by voters in 1919 to prohibit the collection of fees for residential refuse collection or disposal.

Rental Car Surcharge

The Rental Car Surcharge is charged to any daily rental passenger vehicle and is typically collected by the State and distributed to localities where the rental transaction occurred. A surcharge rate of four percent, as found in other cities across the country, could generate \$32.3 million for the City of San Diego’s General Fund.

Retirement Tax

Under Section 76 of the City Charter, the City Council was authorized, if necessary, to levy an ad valorem tax in an amount sufficient to meet the requirements of the City’s pension funds for public safety employees and general city employees. The City levied a retirement tax under this Charter section between 1961 and 1978. The City Attorney’s Office is presently conducting a thorough analysis to determine the current status of the retirement tax provision, given both Proposition 13, and the more recent voter approval requirements imposed by Proposition 218.

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Sales Tax

Sales Tax is levied on the retail price of tangible personal property sold in California, unless specifically exempted. The State Legislature determines the tax rate, which currently stands at 7.25 percent of retail price. Of this percentage, the state collects 5.5 percent, cities collect 1.0 percent for general fund purposes and counties collect 0.25 percent. The remaining 0.5 percent is allocated to cities and counties (0.25 percent each) for the purpose of funding public safety. Counties may levy an additional local Sales Tax, up to an aggregate of 1.5 percent, for general or special purposes. Cities may levy additional Sales Taxes only with special State legislation and approval by local voters. Currently, the County of San Diego levies a half-cent supplemental Sales Tax to finance TransNet, a 20-year, \$3.3 billion transportation program. If the City of San Diego were to levy its own half-cent supplemental Sales Tax, it would stand to gain approximately \$97 million per year.

Special Event Support

Currently, Council Policy 100-06 requires City support of special events for free to the public up to a minimum cost of \$3,000, anything over the minimum is paid by the event coordinators. Special events may include parades, sports events, film making activities and many others. City staff is currently reviewing this policy and any proposed revision to the policy will be brought forward to the appropriate City Council Committee.

Storm Drain Fee

Storm Drain Fees are levied as parcel charges, sometimes adjusted for the parcel area and amount of impervious surface space. The City of San Diego currently collects a fee of \$0.95 per single-family residence and a fee based on water use for multi-residential, commercial and industrial properties. These fees, collected on the City's water and sewer utility bills, generate approximately \$6 million per year. If this fee were to be increased by \$1 per month for residential properties, with comparable fees for commercial properties, additional revenue of approximately \$6.3 million could be generated.

Transient Occupancy Tax

The Transient Occupancy Tax (TOT) is a tax imposed on persons occupying a room in a hotel, motel, inn, or other lodging facility for less than 30 consecutive days. The tax is levied as a percentage of the total rent charged to the occupant for use of the room. Currently, the TOT charged by the City of San Diego is 10.5 percent. This rate is one of the lowest among major California cities. For instance, Anaheim charges a TOT of 15 percent, while San Francisco and Los Angeles both charge 14 percent. A one percent increase in San Diego's TOT would generate approximately \$10.3 million per year in additional General Fund revenue.

Utility Users Tax

The Utility Users Tax (UUT) is imposed on the consumption of public utilities, including electricity, gas, cable television, water, and telephone services. The tax is charged as a

percentage of the consumer's utility bill, which is then collected by the utility and remitted to the city tax collector. Although San Diego does not currently impose a UUT, tax rates statewide range from 0.5 percent to 12.5 percent. Assuming \$15 per capita in revenue, San Diego would generate approximately \$18.5 million for each 1 percent of Utility User Tax if applied against electricity, natural gas, cable television, water and telephone.

Valet Parking Tax

The Valet Parking Tax is in addition to the Parking Lot Tax. Valet Companies are subject to the Parking Lot Tax as listed above, in addition to a tax on the hourly wages for the hired valets and any fee paid by the vehicle operator for the valet parking service. The City of Washington, D.C. currently employs a 12 percent Parking Tax, which extends to all aspects of the Valet Parking Business. Should the City of San Diego implement the 10 percent Parking Lot Tax as listed above, it should be extended to include all transactions associated with the valet parking business, including fees paid for space in a garage where valets park the cars, wages paid to valet drivers, and fees paid to valet drivers by vehicle owners.

6 to 6 Registration Fee

An annual Registration Fee would be charged to 6 to 6 member families not eligible for the Federal USDA Free Lunch Program. Families eligible for the Federal USDA Free Lunch Program would not be charged a fee. This would make this successful program more cost recoverable while continuing to provide economical childcare services to local families.

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STATE BUDGET

After several years of economic prosperity, the State of California's economy, along with the national economy, entered into a recession. The events of September 11, 2001 further weakened California's economy. Recently, Governor Gray Davis announced that the State budget deficit is likely to be \$35 billion. In his 2003-2004 proposed budget and current year plan, the Governor addresses the deficit through major reductions and tax increases. In contrast to last year's plan, which focused on one-time actions such as deferrals and funding redirections, the current plan contains major spending reductions, including across the board cuts in K-12 educational spending, realignment of health, child care and social services programs to local governments and elimination of the backfill for Motor Vehicle License Fees. In addition, the ongoing proposed solution for balancing the State's budget includes permanent increases in taxes on personal income, cigarettes and Sales Tax.

The Governor's proposal to address the State deficit affects the City in several ways. The most significant potential affect is the elimination of the backfill for Motor Vehicle License Fees (MVLF). If approved, the State would no longer provide funding to local governments to make up for the 67.5 percent fee offset for vehicle owners upon registering vehicles each year. State law allows for an increase in the MVLF for vehicle owners when the State's budget is unable to afford the offset to local governments. Some State legislators are confident that this provision will take affect and protect MVLF revenue; however, other legislators and taxpayer advocate groups vow a legal battle should any tax increase be implemented. This amounts to over \$51 million in potential revenue reductions for the City of San Diego in Fiscal Year 2004. The Governor also proposes elimination of the jail booking fee reimbursement for an impact of \$5.2 million. A reduction to the Public Library Fund could cost the City as much as \$565,000. Currently, this grant funds 30 staff positions and non-personnel expense for fundraising. Additionally, City redevelopment agencies may lose up to \$7.5 million due to shifts of property tax increments to the Educational Revenue Augmentation Fund (ERAF).

The following table represents the Governor's proposals that will impact the City's General Fund:

FY 2004 (July 1, 2003)	Governor's Proposal
VLF Backfill	\$51.6 million
Booking Fee Reimbursement	\$ 5.2 million
Libraries	\$ 565,000
6 to 6 Grants	\$ 2.0 million
Road Maintenance	\$ 2.5 million
Total	\$61.8 million

City of San Diego Impact

The loss of these monies in the City's General Fund would force the City to reprioritize the use of existing resources. This may include further reductions to park maintenance and recreation center hours, library services and hours of operation, social services, and allocations to community groups through Special Promotional Programs. Potentially deep reductions to Public Safety could include reductions in the number of detectives on the police force, decrease in air support and decreased availability of Fire Engines and Truck Companies. Although we would prefer not to take these actions, such a large reduction in funds would necessitate an impact to the City's core service programs. Additionally, if the unions are willing to enter into negotiations with the City to modify their contracts, other options such as mandatory work furloughs or reduction to a 36 hour work week may protect funds for Public Safety and prevent extensive layoffs. Finally, new revenue options, as mentioned earlier, could become even more critical to the City's fiscal health.

State of California May Budget Revise

Although the California State Legislative Analyst's Office estimates the State's General Fund deficit to be closer to \$26 billion, all projections indicate that the State's budget will continue to experience dramatic deterioration. The Governor's proposal projects that State revenue will decline from \$73.1 billion in 2002-03 to \$69.2 billion in 2003-04. In accordance with the Governor's proposal for major program reductions and program realignment to local governments, State expenditures are projected to fall from \$75.5 billion 2002-03 to \$62.8 billion in 2003-04.

The State Constitution requires that the Governor submit a budget to the Legislature by January 10 of each fiscal year. An update of the State's General Fund revenues and changes in expenditures, otherwise known as the May Revision, is usually due by May 14. By constitutional requirement, the Governor's Budget must be accompanied by a Budget Bill. The State constitution also requires that the Legislature pass the bill by June 15 of each fiscal year. The City of San Diego Charter mandates, however, that the City Manager release the City's Proposed Budget by the first City Council meeting in May. Consequently, only preliminary information regarding the State of California's fiscal situation and budget proposals that relate to local governments is available at this point in the City's budget process. In the City's June Revision, released in mid-June, updated revenue and expenditure data, including the State's budget status, will be provided to the Mayor and City Council prior to budget deliberations.

Due to the uncertainty regarding the State budget process and the impact on the City, we will continue the current hiring freeze into Fiscal Year 2004 until the State budget is adopted.


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Conclusion

Although San Diego's economy continues to outperform the State and national economies, weak consumer spending and rising unemployment have slowed the recovery. As a result, revenue growth will continue to be lower than historical levels in Fiscal Year 2004.

Furthermore, economic and political uncertainties, such as military deployments and the threat of war, could prolong this financial difficulty into future fiscal years. Because costs continue to outpace revenues, options to ensure the achievement of a balanced budget are being considered. An estimated \$30 million program reduction in the General Fund will result in decreased service levels. While an attempt has been made to minimize the impact, some customers will be affected by the loss of service more than others. Public Safety has remained our highest priority. However, the looming State action that would result in an estimated \$62 million loss of revenue would have a more significant impact on the General Fund and other areas of the budget, and reductions to core services, including Public Safety, could not be avoided without some form of revenue enhancement. Revenue enhancement options are scheduled to be discussed with the Committee on Rules, Finance and Intergovernmental Relations on April 2, 2003. Details of the Fiscal Year 2004 Proposed Budget are being finalized and will be presented to the Mayor and City Council at the first Council meeting in May.

Respectfully submitted,



Michael T. Uberuaga
City Manager